

THAI INSURANCE FACES CRISIS UNLESS BARRIERS TO CONSOLIDATION ARE LIFTED

GURU SPEAK



**PRAPASIRI
KOSITTHANAKORN**

INSURANCE companies operating in Thailand need financial strengthening to ensure the stability of the industry. In order to increase the long-term competitiveness of insurers here, a greater amount of industry consolidation is required.

One spur driving consolidation was introduced in the second amendments to the 2008 Insurance Act. These amendments require insurance companies to maintain statutory reserves which are calculated using the "risk-based capital" framework. These more rigorous capital adequacy requirements will likely encourage business consolidation.

Another compelling force is Thailand's move towards trade liberalisation within Asean and the Asean Economic Community. Once the industry is liberalised, domestic insurance companies will need to compete not only with local insurers but also with larger and more established operators in the region. In order to survive, the capital of the insurance companies – especially small and medium-sized ones – will need to be increased. Mergers and acquisition (M&A) are expected to be utilised as a survival

instrument. Combining smaller insurance companies into larger sized businesses brings with it advantages and economies of scale. These include lower operating costs, easier and faster access to additional capital, and an increase in competitiveness.

The Office of the Insurance Commission (OIC) has also cited promoting insurance industry consolidation as one of its policy objectives.

However, despite the obvious incentives, so far we have seen a limited consolidation among players in the insurance industry. If consolidation is a necessary step forward, what is delaying it?

Is the current taxation regime a support or an impediment?

One factor discouraging consolidation among insurance companies may be the potential tax burden. There are no specific tax rules governing insurance M&A. The available M&A tax schemes, such as for amalgamation, Entire Business Transfers (EBT), or Partial Business Transfers (PBT), work well in other businesses. However, they are not appropri-

ately crafted to accommodate the unique circumstances of the financial services industry, in particular, the tax treatment of policy reserves.

TAX TREATMENT OF POLICY RESERVES

Under Thai tax laws, provisions are usually added back when calculating profits subject to corporate income tax. A special exception is made in the case of life and non-life insurance businesses. Insurance companies are allowed to treat their reserves as tax-deductible expenses at a rate not exceeding 65 per cent for life insurance and 40 per cent for non-life insurance.

Policy reserves are a major component in the accounts of every insurance company. Under current legislation, when two insurance companies merge, these reserves will be subject to tax, imposing a major tax cost on one or both of the merging companies. It has been reported that a proposed merger between two well-known Thai life insurance companies did not proceed for this very reason. The policy reserve potentially subject to tax was expected to be

over Bt10 billion, which would have resulted in a prohibitive and unacceptable cost.

A way forward: Business consolidation within the insurance industry may not materialise unless a specially crafted tax regime is introduced to accommodate the unique circumstances of insurance M&A. Without the change, the tax-related transaction costs will continue to be a deal-killer.

We understand that a cooperative effort between the Insurance Association, OIC, and the Revenue Department is underway to develop a suitable insurance M&A tax reform package. However, the call for the change started in 2008. How much longer does the industry need to wait to be in a position to implement the changes necessary to ensure its continuing competitiveness? The industry is ready and wants to ensure growth and sustainability for Thailand. To do this it needs the relevant authorities to expedite process.

PRAPASIRI KOSITTHANAKORN is a partner, and Orawan Fongasira a director, of Tax & Legal Services at PwC Thailand.